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TREASURY FOR MHIRSON, ABAUKOL, AWELLER, AND MNUGENT
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SUBJECT: AFGHANISTAN RECONSTRUCTION TRUST FUND: QUARTERLY DONORS
REVIEW

REF: Kabul 2056

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11. (U) This is an action message. See paragraph 11.

12. (U) SUMMARY: At the November 10 quarterly review meeting with donors of the World Bank's Afghanistan Reconstruction Trust Fund (ARTF), Finance Minister Zakhilwal challenged the international community to channel more assistance through the government's core budget. He noted that the ARTF is one of the most prominent, credible vehicles for such on-budget support. (Approximately 80% of donor funding to Afghanistan currently passes through the Government's 'external, off-the-book budget.') Zakhilwal also announced that Article 61 (an ARTF Incentive program benchmark - Reftel) was recently put into effect, with full legal status, according to the Ministry of Justice. Article 61 of the Public Financial Management Law enables the Ministry of Finance to conduct internal audits of other line ministries. At the meeting, the Ministry of Rural Rehabilitation and Development (MRRD) rejected recent press allegations that the National Solidarity Program's (NSP) was providing indirect financing for the Taliban. ARTF remains an important and transparent vehicle for international assistance to Afghanistan, and a prime means through which to encourage the Afghan government to make needed economic reforms. We recommend that the United States encourage other donors to increase their contributions to the fund. END SUMMARY.

ARTF Financial Status

13. (U) Finance Minister Omar Zakhilwal and World Bank Country Manager Mariam Sherman co-chaired the ARTF quarterly meeting, which had been delayed by the attack on a UN guest house in Kabul on October 28. They reviewed current financing: Donors have currently pledged \$654 million to the ARTF in FY 1388 (March 21, 2009 - March 20, 2010), up from \$626 million in FY 1387 (March 21, 2008 - March 20, 2009). Key sectors in the active investment portfolio (which funds programs), valued at over a \$1 billion, include: Agriculture and Rural Development; Microfinance, Energy, Health and Education, and justice. USAID Mission Director William Frej stressed the importance that ARTF-funded programs demonstrate concrete results

and impact. In addition to a newsletter and video to improve communication and outreach, the World Bank is discussing putting a new third-party monitoring agent in place for the investment window. PricewaterhouseCoopers of Netherlands is currently the monitoring agent engaged by the Bank in its role as ARTF Administrator to review expenditures through the ARTF recurrent cost window (which funds government operating expenses such as salaries, operations and maintenance).

ARTF Financing Strategy/Incentive Program

¶4. (U) To build on the forward-looking ARTF incentive program and to reduce the amount of preferencing (earmarking) over time, the Government of the Islamic Republic of Afghanistan (GIROA) and the donors endorsed a Financing and Investment Framework at the July 29, 2009 Quarterly donor meeting. The Framework will improve the predictability, efficiency and transparency of ARTF resource allocations by establishing principles for the allocation of investment fund monies. It will also set priorities for ARTF donors and the GIROA. ARTF operations are governed by a Management Committee, consisting of representatives of the Asian Development Bank (ADB), Islamic Development Bank, UNDP and World Bank. Day-to-day administration is undertaken by the World Bank as the Administrator of the ARTF. The Management Committee meets once a month and is attended by the Government of Afghanistan as an Observer.

¶5. (U) At the meeting, Deputy Finance Minister Mastoor presented the GIROA's proposed detailed implementation for the Financing Strategy Framework: 1) the ARTF would remain the main financing channel for GIROA priorities; and 2) as stated at the 2008 Paris Conference, Agriculture, Energy, and Irrigation would continue to be

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its top priorities. Next steps would include aligning the ARTF Financing strategy with the FY 1389 (March 21, 2010 - March 20, 2011) national budget. Finance Minister Zakhilwal also asked donors to provide funding more closely aligned to the Afghan solar year to ensure a smoother implementation of national programs vs. the more common practice up to now of receiving funds in the winter, which delays implementation of programs. USAID plans to submit an early release of FY 2010 ARTF funds to better align to the Afghan Solar Year (March 2010), thereby providing financial support to GIROA programs on a more timely basis.

¶6. (U) The Finance Minister "welcomed pressure" from donors in promoting reforms via the ARTF Incentive Program, in the areas of: A) Sustaining domestic revenues; B) Improving public sector governance; and C) Enabling private sector development. The Finance Minister is fully committed to meeting benchmarks in the off-setting incentive program, which essentially offers additional discretionary funding if the GIROA meets certain pre-agreed benchmarks on an annual basis. He also requested that donors "relax" preferencing to allow for increased flexibility in ARTF funding. Preferencing at the program/project level, he said, has been too restrictive and limits the ability of the GIROA to adopt sector-wide approaches implementing the Afghanistan National Development Strategy (ANDS). USAID Mission Director William Frej noted that lobbying for specific programs by individual Ministers, in particular, MRRD Minister Zia, has resulted in legislative earmarks to the National Solidarity Program (NSP).

Article 61

¶7. (U) In 2007, the Control and Audit Office (CAO) objected to Article 61 of the Financial Management and Expenditure Control Law (included under the ARTF's benchmarking incentive program). The CAO argued the article ceded too much power to the Ministry of Finance (MoF). As a result of CAO's objection, the president assigned a commission to study the matter. The commission later recommended terminating Article 61 and restricting the purview of the Ministry of Finance's Internal Audit Department to MoF-related departments

only. The president signed off on this opinion. The Ministry of Justice recently clarified, however, that Article 61 is in force, granting the MoF purview over internal audits in line ministries. MOJ added that any changes to the Financial Management Law require going through proper channels and publication in an official gazette, which were not done in this case.

NSP ALLEGATIONS NOT TRUE

¶8. (U) The Ministry of Rural Rehabilitation and Development's NSP Executive Director Tariq Ismati provided an update on his ministry's investigation into recent press allegations that the NSP indirectly funds the Taliban. (On August 10, 2009 a Global Post article claimed that "in Farah province, local officials report that the Taliban are taking up to 40% of the money coming in for the NSP...") According to Ismati, a high-level MRRD delegation uncovered no indications that monies were paid to Taliban groups. Ismati also said that NSP operates in six out of Farah's 11 districts, with 76 projects currently underway (47 of which are in insecure districts), at a total value of \$1,127,723. Key results include: 1) 9,522 wells dug with pumps; 2) 31 schools opened, in coordination with the Ministry of Education; 3) 470 culverts built; and 4) 658 kms. of village and districts gravel roads. All of these projects came in at costs well below similar ones executed by PRTs using CERP funds.

¶9. (U) The investigation included interviews with the Farah Governor, the PRT (i.e. PRT Commander, USAID Representative, Marine Forces, etc.), the Director of Tribes and Frontiers, Community elders, Community Development Councils, UN-Habitat, Provincial Officials, etc. Documents and financial records were also cross-checked and noted as compliant with NSP Operational Manual standards. (Comment: On November 12, Ambassador Wayne asked MRRD for a report on NSP projects performance in the South after

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receiving reports that NSP projects had floundered in several southern provinces with heavy insurgent activity. The Deputy MRRD Minister admitted problems and promised a report including how the MRRD has adapted its approach.)

COMMENT

¶10. (U) In concert with the Afghan government and other donors, our Mission will continue to work with the ARTF to track progress, align technical assistance to meet and implement economic reform benchmarks (i.e. Article 61), and implement the ARTF's Financing Strategy. In particular, the Afghan government's Financing Strategy offers donors an opportunity to work with the new Government to further align ARTF resources to GIROA priorities. Donors were also pleased to see that the World Bank/MRRD is taking investigations into corruption seriously and conducting due diligence. Clear follow-up on the allegations and a reiteration of risk mitigation measures are needed, however. We also recommend additional measures be explored and implemented in high-risk areas vulnerable to Taliban extortion moving forwards.

¶11. (U) Action request: We recommend Washington consider undertaking a broader diplomatic effort to solicit greater ARTF pledges from other donors. (The U.S. and the UK now provide half of the total ARTF funding). This initiative is consistent with President Obama's emphasis on greater Afghanization of assistance, enabling the Afghan government to take the lead in national programs. As noted above, USAID also plans to submit a request for an early release of FY 2010 ARTF funds to provide financial support to GIROA programs on a more timely basis.

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